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In The

Supreme Court of the United States

October Term, 1978

No. 78-1403

ALFRED KIRSHNER,

Petitioner,

-v-

UNITED STATES OF AMERICA, SECRETARY OF THE TREASURY, COMMISSIONER OF I.R.S., ALVIN D. LURIE, in his capacity as Assistant Commissioner Employer Plans and Exempt Organizations, I.R.S., BERNARD GOLDBERG, REUBEN MITCHELL, JOSEPH SHANNON, ROBERT CHRISTEN, HARRISON GOLDIN, JAMES REGAN, Individually as Trustees of the Teachers Retirement System of the City of New York and ISAIAH ROBINSON,

Respondents.

BRIEF AMICUS CURIAE SUBMITTED BY NATIONAL EDUCATION ASSOCIATION/NEW YORK CITY IN SUPPORT OF PETITION FOR CERTIORARI

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UNITED STATES OF AMERICA, SECRETARY OF THE TREASURY, COMMISSIONER OF I.R.S., ALVIN D. LURIE, in his capacity as Assistant Commissioner Employer Plans and Exempt Organizations, I.R.S., BERNARD GOLDBERG, REUBEN MITCHELL, JOSEPH SHANNON, ROBERT CHRISTEN, HARRISON GOLDIN, JAMES REGAN, Individually as Trustees of the Teachers Retirement System of the City of New York and ISAIAH ROBINSON,

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INTEREST OF AMICUS

The National Education Association/ New York City is an affiliate of the National Education Association, an organization of 1,800,000 members employed as teachers and paraprofessionals in the education field. The amicus is vitally interested in all issues affecting the teaching profession. The questions raised by this case concern the security of the Teachers Retirement System of New York City in particular, and the safety of all public employee retirement systems in general. The members of approximately 30% of all government plans are school teachers.

That petitioner herein has proceeded pro se in an extraordinarily complex and difficult case, makes the submission of an amicus brief prepared by counsel most desirable, if not necessary, to frame and present the issues and facts more satisfactorily than he has been able to do. In particular, there is considerable matter on the public record and the record of this case which should be called to the Court's attention regarding the operation of the New York City Pension Funds during the City fiscal crisis. The resolution of the difficult question regarding the use of pension

fund assets by an employer, in this case New York City, in times of financial stress and the standing of a pensioner to raise these issues will affect intimately each one of our members. We believe our brief will assist* the Court in resolving those questions.

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*Letters of consent by petitioner pro se and the Solicitor General of the United States for respondents to the filing of this brief have been lodged with the Clerk of the Court.

STATEMENT OF THE CASE

The Teachers Retirement System of the City of New York ("TRS") is a pension trust funded in part by the compulsory contributions of New York City Board of Education teachers and in part by contributions of the City of New York ("the City"). In 1974, there were approximately 25,000 retired and 80,000 employed members of the System. The petitioner, a high school science teacher who was retired as disabled in 1953, received a pension of approximately $3,000 a year and, at age 69 when the proceeding was commenced, was entitled to a lifetime pension, the actuarial value of which was $39,000.

Upon the retirement of a TRS member, amounts deemed sufficient to fund the member's lifetime pension are transferred on the books of TRS to its annuity reserve and pension reserve funds. Of the $1.85 billion of assets* on hand as of June 30, 1974, 87% - 1.62 billion dollars - had been so transferred to fund pension payments to members who had already retired. Total accrued liabilities of TRS were $4.62 billion.

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* Unless the contrary appears from the context, the values set forth herein are par values.

The poor - one might say critical - condition of TRS in 1974 was self-evident. Although the pensions of the retirees were considered to be fully funded, very little - but $0.23 billion - was available to meet all other liabilities. And, should there be significant losses in the value of the securities funding the retirees' pensions, there were few assets available to replenish those funds. The New York State Permanent Commission on Public and Employee Pension and Retirement Systems concluded in March, 1975 that not only was the ratio of assets to liabilities of active members an "unbelievabl[y]" low 9% in TRS, but also that soon "the assets will be insufficient to cover the pension reserve for retirees . . . ."* Further, since the actuarial assumptions used by the TRS were highly inaccurate and archaic, it is probable that, even in 1974, the pensions of the retirees were seriously underfunded.**

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* New York State Commission on Public and Employee Pensions and Retirement Systems, Financing the Public Pension Systems 37 (New York: Permanent Commission, March, 1975) ["the Kinzel Report"]

** Kinzel Report at 12-13. See, in general, Securities and Exchange Commission Staff, Report on Transactions in Securities of the City of New York, Chapter 2 at 49-61 (Washington: Gov't. Print. Of. 1977) ["SEC Staff Report"].

One would have thought that under such circumstances the Trustees and the City would have taken steps to improve the solvency of the TRS. In the event, the opposite happened.

During the period of October, 1974 through March, 1975, New York City's increasing fiscal problems forced it to issue over $4 billion in short-term notes. Rather than improving its financial status, such issue led to a complete foreclosure from the public capital markets by March, 1975.* Although once the source of significant loans and still holding some amounts of City notes, the New York City commercial banks were unwilling to extend any further credit to the City and refused to buy or try to market City notes after April 4, 1975.**

Closed out from public capital markets, the State and City government sought new sources for raising money. In June, 1975 the State created a Municipal Assistance Corporation for the City of

*Securities and Exchange Commission, Final Report in the Matter of Transactions in Securities of the City of New York, Securities Act of 1933 release no. 6021 (Feb. 5, 1979) at 1.

** The banks had begun selling their own investments in City obligations as early as September, 1974 and had avoided purchase of City securities for their own and fiduciary accounts. SEC Staff Report, supra, Chapter 4 at 31. Nonetheless, the holdings of the banks exceeded $1 billion in March, 1975. Id., at 3.

New York ("MAC") which, through the sale of bonds, could provide the City with funds needed to pay maturing City notes.

But the sale of MAC bonds did not generate funds sufficient to meet the City's needs. The State and Federal governments were also insufficiently responsive to the requirements of the City and other sources of funds were not immediately visible - except for several billions of dollars in the five city pension trusts.* True, those funds were held by the Trustees for the benefit of city employees both retired and active, and not for the benefit of City bond-holders. Outright seizure of the funds was clearly impossible, both legally and politically.

* "In a very real sense, the City's pension plans became the last repository of any sizeable amount of funds for the City to draw upon during its fiscal crisis. The City's continued access to public markets was in jeopardy, the large financial institutions were threatening to withdraw further support of the City, and the City's cash needs were escalating. Faced with these crises, the City turned to its last source of funds, the pension funds, which were freely utilized in an attempt to shore up the City's finances." SEC Staff Report, supra, Chapter 3 at 95.

With a cynicism seldom surpassed in municipal financing, the City and banks nevertheless turned to the pension trusts and, by a series of legal steps, some of which are the subject of this lawsuit, were able to divert those funds to meet the City's indebtedness.* The result was to strip the TRS of still more of its assets and to reduce the assets held to fund the pensions for retired employees to the point where the obligation was not funded at all, in violation of §B20-27.0 of the Administrative Code of the City of New York. As a result of the scheme developed in the next few months, the TRS, which had, in 1974, held only $110,000,000 in City obligations,** increased its holdings in public, tax-exempt securities to close to a billion dollars.

TRS purchased $275 million of first resolution issue 11% MAC bonds by September, 1975. However, the total raised by MAC was not sufficient for the City's needs and the security of MAC bonds themselves was doubted

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* We do not discuss the moral implications of the actions of the defendants, although we are loath to believe that the Court will consider them totally irrelevant.

** The System's 57th Annual Report, Fiscal Year, 1973-74, at 25.

by investors. On November 14, 1975 a Moratorium on actions to enforce the City's short-term obligations was enacted by the New York State Legislature.* On November 15th the City defaulted on its outstanding notes maturing that day.**

The City and the commercial banks once again moved against the funds held in the pension trusts.*** These trusts were uniquely susceptible to pressure: the Trustees of the TRS were City and Board of Education officials, mayoral appointees, and three persons elected by active teachers, all of whom were members of the Teachers Union which was engaged in collective bargaining with the Board of Education. The retired pensioners were "aged, widely scattered, unorganized, politically powerless, without representation and voiceless [in the management of

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* N. Y. Laws 1975, Chapters 874, as amended by Chapter 875 (McKinneys, 1975).

** See Flushing National Bank v. Municipal Assistance Corporation, 40 N.Y.2d 731, 747-748 (1976) (dissent) for a summary of legislative and executive actions undertaken during the period.

*** The banks held significant amounts of City notes which, by virtue of the Moratorium, had lost at least 50% of their market value and could not be redeemed for at least three years.

TRS]."* Funds to finance complex lawsuits in self-defense were not available. If we may be permitted to mix metaphors, TRS was a sitting duck about to be plucked.

On November 26, 1975, only eleven days after the City had defaulted on its obligations, an agreement (the "Agreement") was reached among the major New York City commercial banks, five New York City Pension Funds, the NYC Sinking Funds and MAC, by which the Pension Funds agreed to purchase $2.5 billion of City bonds.** For its part, TRS agreed to purchase $860 million of City bonds before June 30, 1978 which would be paid for primarily through the sale of its current assets. TRS also agreed to exchange high interest (11%) MAC bonds for other MAC bonds bearing only 6% interest. The purchases were agreed to by the Pension Funds even though the major rating agencies had either completely suspended their rating of City bonds or downgraded them to their lowest category (6a). The 6% MAC bonds, rated by Moody's at B (6a), were considered highly risky and insufficiently secured.

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* Affidavit for preliminary injunction of petitioner, sworn to March 17, 1977.

**Agreement is set out at 121 Cong. Rec. S.21,308-S.21,310 (daily ed. Dec. 5,1975).

The "Agreement" was contingent, however, upon the fulfillment of certain conconditions including, inter alia, that

> the Internal Revenue Service shall have ruled or the Congress of the United States shall have provided, that such purchases of obligations by the Pension Funds pursuant to this Agreement shall not constitute prohibited transactions or otherwise adversely affect the qualified status of the Pension Fund for the purposes of the Internal Revenue Code of 1954, as amended.

Under the Internal Revenue Code, a pension plan loses its tax exempt qualified status if it fails to conform to the provisions of 26 U.S.C. 401(a) and §503(b). Additionally, pursuant to IRS rulings, assets may not be diverted to the benefit of the employer, in this case, the City, unless certain conditions are met. All parties to the Agreement were aware that the purchases agreed to by the System were, as of the date of the Agreement, unlawful and improper as not in conformity with the applicable statutes and regulations.*

Furthermore, the Agreement was contingent upon the enactment of federal

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* See Rev. Rul. 69-494, 1969-2 Cum. Bull. 88. (fn continued)

"Seasonal" loan legislation by the Congress.** The plan to provide New York City with funds, the source of which was to be the Pension Plans, was complete.

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* (fn continued) The House Committee on Educational and Labor concluded:

> "Inasmuch as the agreement to purchase the city securities was itself contingent on (1) exemption of the purchases from the Internal Revenue Code prohibited transaction and exclusive benefit rules, and (2) passage by the New York legislature of a bill indemnifying the plan trustees against liability for making such purchases, it was implicity recognized by all the parties to the agreement that governmental plan assets were to be used for some purpose other than generating income to the fund or defraying reasonable administrative expenses."
>
> House Com. on Education and Labor, Pension Task Force Report on Public Employee Retirement System, 95th Cong., 2d Sess. (Comm. Print, March 15, 1978) at 194 ["PERS Report"].

** Agreement at ¶¶ 6, 7(e)(vii). That legislation was signed by the President on December 9, 1975, the New York City Seasonal Financing Act of 1975, P.L. 94-143, 89 Stat. 797 (1975).

Legislative leaders and the President implicitly agreed to pass legislation to permit the agreement to go forward.* Because even more capital than the $2.5 billion was needed, the federal government agreed to provide the rest through the loan program.

When the agreement was made, New York City securities were selling far below their par value. On November 5, 1975, before the enactment of the Moratorium, city notes were traded at 35% below par value. After the Moratorium, the market value of City securities had dropped almost 50%. Thus, when TRS and other pension funds agreed to purchase more City bonds at par value on November 26, 1975, they knew that the real value of their holdings would be substantially reduced. The risk of further City default on all its obligations was extremely high.

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* Charles M. Walker, Assistant Secretary of the Treasury for Tax Policy, testified in House hearings on H.R. 11700 [P.L. 94-236] that the federal financing guarantees was enacted by Congress with the understanding that the Agreement would be implemented. Hearings on H.R. 11700 before the House Committee on Ways and Means, 94th Cong. 2d Sess. at 3 (1976). The Agreement, for its part, was dependent upon the enactment of legislation. A quid pro quo had been set.

Petitioner's and all pensioners' benefits were no longer guaranteed since their pensions no longer were fully funded.*

In December, 1975 the TRS sought approval for the purchase of $182 million in City bonds which was granted by IRS in letters from Assistant Treasury Commissioner Lurie dated December 5th and 13th, 1975. TRS sold $212 million of "sound, varied and highly-rated corporate bonds" at a loss of $30 million and purchased the $182 million of low grade, NYC securities, at par, a price 20% above market value (7a). On February 1, 1976, pursuant to the Agreement,

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* Because of the course of purchases and sales undertaken by the respondents, approximately 45% of the TRS portfolio now is City and MAC securities. Petitioner alleged that $204 million was lost in premature and imprudent sales of high quality bonds to purchase the securities. Petition for certiorari at 7. The $1.62 billion in assets pledged to the pensions, a valuation based on par and book value, not market value, does not now guarantee future payment of petitioner's pension (if it ever did - see supra, p.3) because the real value of assets is much lower. A witness at Congressional hearings had stated that the assets of the City pension funds actually were worth at market only 65% of their stated value in December, 1975. House Report No. 632 - Part I, "Minority Views on H.R. 10481," 94th Cong., 1st Sess., 1975 U.S. Code Cong. Adm. News 1549.

TRS exchanged the 11% MAC bonds, in the principal amount of $215 million, for others bearing 6% interest.

Had approval been denied or any of the other conditions not been met, TRS might have been obliged to purchase only $170 million of MAC bonds but only if the President of the United States had announced publicly his support for federal financing legislation for the City.* No other purchases were required by the Agreement if IRS approval was withheld or no legislation excluding the pension funds from the safeguards of § 401 (a) was enacted. Indeed, further purchases would have been in violation of §§ 401 and 503.

At hearings before the House Committee on Ways and Means, the Treasury Department enunciated its support of H.R. 11700 [P.L. 94-236], concluding that the purchases in the Agreement otherwise would be unlawful.** The passage of P.L. 94-236, 90 Stat. 238 (1976), approved March 19, 1976 was the final precondition to the complete fulfillment of the Agreement. P.L. 94-236 provided that, of the 600,000 employee pension plans in the nation, only the five New York City pension funds which were

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* Agreement, ¶ 7(f). $170 million was TRS's proportionate share of $500 million, as set forth in Schedule D of the Agreement.

** Testimony of Charles M. Walker, supra.

parties to the Agreement were exempted from compliance with 26 U.S.C. §§ 401(a) and 503(b) with respect to their dealings with the City, MAC and New York State. As a direct result, TRS continued its purchases of City and MAC obligations. Approximately 50% of the System's assets were destined to be New York City and MAC notes and bonds by June 30, 1978.*

The impact of these purchases of City and MAC obligations on the security of petitioner's pension was substantial. The real value of the System's portfolio, concentrated in illiquid, unsaleable City and MAC securities, dropped precipitously, not only because of the character of the securities purchased, but because their purchase was made possible only by the sale of sound securities at a loss.

ARGUMENT

The court below affirmed the dismissal of the action against the federal defendants because it reads the December IRS rulings and P.L. 94-236 as enactments designed to protect the tax-exempt status of pension trusts while they engaged in conduct which was, but for 26 U.S.C. §§ 401(a) and 503(b), legal and proper.

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* About $1.2 billion of TRS's assets (valued at par or book value) were City and MAC securities by November 1978. TRS Monthly Report, Nov. 30, 1978.

If such were the purpose and effect of the statute, the court's conclusion that the statute caused no harm to the petitioner (10a) and benefitted, rather than damaged the City and its creditors (12a), might have been sound, but the court misunderstood petitioner's argument and the nature of the transaction of which he complains.

Here the petitioner complains, not that the TRS was permitted to keep its tax-exempt status and still buy City bonds; he complains rather that TRS was permitted to buy City bonds under the circumstances described above. It was the purchase of the bonds, made possible by the passage of P.L. 94-236 - amounting to a de facto seizure of the funds of TRS by the City - which is the gravamen of his complaint. It is difficult to see how the petitioner did not suffer grievous harm as a result of that purchase.

It was the acquisition of City securities and the losses which attended those purchases that was the "injury in fact", Association of Data Processing Service Orgs., Inc. v. Camp. 397 U.S. 150, 152 (1970). Had IRS or P.L. 94-236 not removed that "question as to tax-exempt status" (12a), the purchase could not have occurred. But for the December IRS rulings and P.L. 94-236, petitioner would not have suffered injury.

The issue of petitioner's standing is

composed of several closely interrelated elements. The first is the constitutional issue over whether there is a "case or controversy" between plaintiff and defendant; the second is whether there is a casual connection between the actions complained of and an injury to petitioner; the third is "whether the interest sought to be protected by the complainant is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question." Association of Data Service Orgs., Inc. v. Camp, supra at 153.

Accepting as true all material allegations of the complaint and construing it in favor of petitioner, Warth v. Seldin, 422 U.S. 490, 501 (1975), petitioner meets all of these tests. He has shown the necessary "personal stake and interest that impart the concrete adverseness required by Article III", Barlow v. Collins, 397 U.S. 159, 164 (1970). As a beneficiary of TRS, petitioner's interest in the safety of the trust's corpus is self-evident. "[S]eparating the legal and beneficial incidents of ownership of property is a mere technical argument since there is only one interest at stake and that is the beneficiary's." James v. Gerber Products Co., 483 F.2d 944 (6th Cir. 1973). Because the pension plan is no longer fully funded, as the intended recipient of the benefits petitioner has

suffered a threatened, if not actual, injury. Indeed, by recognizing his standing to assert claims against the trustees, the court below implicity acknowledged petitioner's personal stake in transactions involving the pension trust's corpus. The "distinct and palpable injury" to petitioner is apparent by the invasion of his rights under the trust agreement and applicable State and Federal law.

The casual connection between petitioner's injury and action complained of meets the "prudential limitations" requirement of the exercise of federal jurisdiction, Warth v. Seldin, supra at 501.

Petitioner's interest in TRS is within the zone of interests protected or regulated by 26 U.S.C. §§ 401(a) and 503(b). The IRS Code provisions were designed "[t]o insure diversification of the investment of funds

and to protect the interests of covered employees." House Report No. 1337, 83rd Cong., 2d Sess., 1954 U.S. Code Cong. & Adm. News 4017, 4071. See also McClintock-Turnkey Co. v. Commissioner of Internal Revenue, 217 F.2d 239 (9th Cir. 1954). Thus, petitioner's de facto exclusion from those prophylactic provisions entitled him to federal court review of its legality.

Petitioner's right to object to actions effectuating the diversion of TRS's assets is also provided by state law giving rise to still another source of standing. Members of a City pension system have a "contractual" right to their benefits which may not be impaired or diminished. N. Y. Const., Art. V, §7. This "contract" extends to the investment of the retirement funds themselves, as a retiree may object to a "radical change" which threatens the "integrity and security" of the investments. Sqaglione v. Levitt, 37 N.Y. 2d 507, 512 (1975).* Thus, by virtue

*Given the long-standing requirements of the IRS Code regarding prohibited employer transactions, the generally recognized need to avoid an imprudent concentration of securities in obligations of one or related debtors, and speculative nature of the City bonds, petitioner's attack on the purchases goes beyond simply an assessment of the "market worthiness" of the securities, which is left to the discretion of the trustees, Scaglione, supra, at 513. Although the securities are assertedly not proper investments, petitioner's (fn. cont.)

of state law, petitioner has a "property" interest in the integrity and security of the investments of the System, a state-created right subject to the protection of the Constitution. Board of Regents v. Roth, 408 U.S. 564, 577 (1972); Meachum v. Fano, 427 U.S. 215, 226-7 (1976).**

This case factually is far removed from Simon v. Eastern Kentucky Welfare Rights Org., 426 U.S. 26 (1976) where it was "purely speculative" whether the Commissioner's

*(fn. continued)
claims are premised upon the invalidity of the entire legislative scheme. However, see contra, Withers v. Teachers' Retirement System of the City of New York, 447 F.Supp. 1248, 1260 (S.D.N.Y. 1978).

**In significant part, it is petitioner's contributions which were used to purchase securities and were entrusted to TRS for repayment to him upon retirement, cf., International Brotherhood of Teamsters v. Daniel, ___ U.S. ___, 47 U.S.L.W. 4135 (1979). Concluding that while not essential to its holding that a pensioner has a protected interest in the City pension funds, the New York Court of Appeals noted that this employee contribution was a "salient fact" to be considered. Sqaglione, supra at 512.

ruling had the effect of denying the petitioners' hospital services. Id. at 42-43. Here, federal government officials testifying before the Congress and members of Congress itself have conceded that the complained-of purchases were made only because the rulings were made and legislation enacted. "But for" the federal defendants' acts, petitioner would not have suffered the injury he did.*

The court below mistakenly concluded that since the maintenance of New York City financing is a legitimate government interest, any statute arguably

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*That the injury can be redressed by the exercise of the court's power, Simon v. Eastern Kentucky Welfare Rights Org., supra at 43, is clear. Declaring that the purchases would not be proper would cause the annulment of the Agreement. Through application of the court's equitable powers, the City securities illegally purchased could be sold over a period of time and TRS restored approximately to the condition it was in before November, 1975. See, e.g., Flushing National Bank v. Municipal Assistance Corp., 40 N.Y.2d 1094 (1977), where a gradual redemption plan for City notes was developed by the New York Court of Appeals following its holding that the Moratorium was unlawful.

having that goal would be proper. However, when a statutory classification has the effect of singling out particular individuals to bear the cost of advancing the public convenience, that imposition must bear a reasonable relation to the advantage to be secured. Nashville, C. & St. L. Ry. v. Walters, 294 U.S. 405, 429-430 (1935). The statute here, P.L.94-236, which ratified the IRS rulings, discarded those protections provided petitioner and the other beneficiaries of TRS. No alternative standards or protection were imposed. The result was the dilution and diversion of assets, assets purchased with money contributed by the teachers themselves. That result is unreasonable and constitutes an uncompensated taking.

All the fiduciary safeguards at common law and those codified by state and federal statute mean nothing if, as here, they can be jetisoned at will. Ironically, the words of the minority in House Report No. 632 - Part 1 on the New York City Seasonal Financing Act of 1975 were prophetic:

> "We are aware of the New York State Court of Appeals decision that a trustee cannot be mandated to invest the funds under his control in Big Mac bonds.

> We are also aware of the law limiting the percentage of investment that may be invested in any one asset by a trustee. We likewise are aware of the Prudent Man Rule governing the proper investment conduct of trustees. And we are aware that short of bankruptcy, you cannot change the vested contract rights of beneficiaries of retirement and pension systems.
>
> But strange things happen to established rules and laws when bankruptcy stares a State or municipality in the face if they do not make full use of billions of dollars of assets that have been used and are being siphoned out of the State's and City's income streams."
>
> 1975 U.S. Code Cong. Adm. News at 1549 (94th Cong., 1st Sess.) [emphasis supplied]

It is these "strange things" that have happened here that concern your amicus. The poor, aged and largely unrepresented and unheard pensioners at best

have been ignored, at worst preyed on by those making political decisions regarding City financing. Their property interest has been diminished without compensation.

CONCLUSION

We have set forth above, in some detail, the circumstances out of which this litigation arose. We conclude this brief by calling to the Court's attention some of the recent history with respect to efforts by the government to protect pension plans.

Prior to 1974, it was generally recognized that the ever-increasing number of pensioners in the United States were inadequately protected by existing law. The result was the enactment of the Employee Retirement Income Security Act, 29 U.S.C. § 1001 (ERISA), which set up an elaborate system of rules designed to protect pensioners and members of pension trusts. State and city pension funds were expressly exempt from ERISA (29 U.S.C. § 1003 (b)(1)) because Congress wanted information "regarding whether a need exists for further regulation of governmental plans." PERS Report, supra, at 1. The word "further" can only refer to federal and state

regulations governing the conduct of such plans. The most important of those regulations were §§ 401(a) and 503(b) of Title 26. What P.L.94-236 did and was intended to do, was to remove even the protection of those statutes from the beneficiaries of the five New York City retirement plans, leaving petitioner outside the protection of either ERISA or the relevant federal statute.

We urge that the petition for certiorari be granted.

Respectfully submitted,

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